United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL 75-4124

B P/S

United States Court of Appeals

For the Second Circuit

AARON KRAUT and IRIS KRAUT,
HARRY KRAUT and MARIAN KRAUT,

Petitioners-Appellants,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

REPLY BRIEF FOR APPELLANTS

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Introduction

The Commissioner states: "This case is on all fours with *Berenson*" (Br. p. 22). We agree. The Commissioner further says: "Under the clear teaching of this Court's decision in *Berenson,* only that portion of the sales price that represents the amount taxpayers would have received from a non-exempt purchaser can qualify for the capital gains rates" (br. pp. 23-24). Again we agree.

But we disagree with the Commissioner's naked conclusion, a *non sequitur* if we ever saw one, that therefore

this Court should let stand his original arbitrary determination of $168,445.60 as the value of the stock of Nassau Corp, a figure which Judge Raum with insufficient analysis and without the *Berenson* guidelines, accepted.

Aside from the Commissioner's gratuitous insult that in his opinion the stock of Nassau Corp was worth no more than $168,445.60, his conclusion is

(a) supported by not one iota of evidence offered at trial;

(b) clearly reflects a cash value for a business the sale of which the parties elected to make on pay-out terms (not for cash), which is contrary to this Court's guidelines in *Berenson;* and

(c) is economically patently absurd based on the fact that the one year's profits for which he seeks additional tax exceeded $1,000,000.

Under the guidelines in *Berenson* v. *Commissioner,* 507 F. 2d 262 (2d Cir. 1974), only that portion of the purchase price "that is in excess of the price a nonexempt purchaser would have paid under identical terms" (at p. 269) is taxable as ordinary income.

In order to make a determination as to whether any portion of the proceeds constitutes such an excess, this Court indicated either of two alternative arithmetical methods in arriving at an evaluation:

(a) either reduce the purchase price by an amount of the extra purchasing power offered the purchaser by reason of its tax exempt status, or

(b) by direct evidence prove what an nonexempt business entity would have paid.

We submit that whichever method is employed the result below is a manifest error based on *Berenson*.

ARGUMENT

POINT I

The amount of extra purchasing power a tax exempt entity has is equal to the amount of the taxes that it does not have to pay.

The Commissioner observed in his brief (br. p. 30) that this Court found it necessary to remand the *Berenson* case in order for a determination to be made as to the portion of the purchase price that was "attributable solely to the extra purchasing power possessed by Temple by virtue of its tax exempt status."

He then suggests that there are other factors than the extra purchasing power a tax exempt entity has which must necessarily be considered on a case-by-case basis. We agree. All we intended to say in our main brief was that the corporate tax bracket of 48% for the year 1967 is the maximum that the extra purchasing power could buy. Obviously, if a tax exempt entity buys a business for all cash it has no extra purchasing power whatsoever. Only in the case of a pay-out on future net profits which are magnified by reason of the exemption from the payment of federal taxes is there an advantage to the tax exempt purchaser.

On the other hand, there are offsetting factors in the case of a tax exempt entity. For instance, there is the in-

ability to conduct the business in a corporate form, thus exposing it to risk operating losses as well as product liability. Also, a nonexempt purchaser may have business reasons for his purchase such as a desire to expand, or a vertical integration into his existing operation, or a net operating loss carry-over. Under such circumstances it is possible that he would pay a price as high as, or even in excess of, that which a nonexempt charity might pay. But in no event would his purchase price be less than the amount of the corporate tax in effect at the time of his purchase.

POINT II

The alternative method for determining whether or not there was an excess is direct evidence as to what a nonexempt entity would have paid.

Again, in the language of *Berenson* quoted above, the issue can be stated as what would a nonexempt purchaser have paid on *identical terms*. In the instant case, had the sales contract which called for payments out of 75% of net profits been made with a nonexempt purchaser, it is obvious that the petitioners would have received 48% less than the Church, in fact, paid to them. Therefore, that must be the maximum of the excess.

We cannot believe that the Commissioner seriously contends that any businessman wouldn't have jumped at the chance to buy Nassau Corp on that basis. It is more obvious to us that petitioners would never have sold.

Further, on the alternative method for determining whether or not there was an excess, the taxpayers at the

trial submitted ample evidence as to product uniqueness, order backlog, and inherent product profitability. We submit that the burden was then on the Commissioner to go forward with some evidence substantiating his original and wholly arbitrary determination of $168,445.60. His failure to do so is cause enough for this Court to reverse the holding below.

The government contends in its brief (br. pp. 14, 27), that the taxpayers produced no expert testimony. This is not true. The taxpayers produced Aaron Kraut and he is as good an expert as there is, if not better, on the fair market value of the stock of Nassau Corp. Judge Raum in his findings stated that Aaron Kraut and his brother Harry had been in the business of developing and manufacturing electric wire of various types for at least two decades (J.A. 275).* This makes them as good experts as any, if not better, on the fair market value of the stock of Nassau Corp.

There is no magic in the word, expert. An expert is anyone with specialized knowledge, no matter how acquired, whether by study, training or experience. A knowledgeable farmer who has purchased and sold land in his area is an expert on land values in that area. As the new Federal Rules of Evidence provide in Rule 702:

"Testimony by Experts

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as

* References to J.A. are to pages of the Joint Appendix.

> an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise."

Rule 702 recognizes that it is the actual qualifications of the witness that count. An expert can be qualified by experience or training. See, *e.g., Southern Cement Co., Div. of Martin-Marietta Corp.* v. *Sproul,* 378 F. 2d 48, 49 (5th Cir. 1967) ("practical mining experience"); *Grain Dealers Mut. Ins. Co.* v. *Farmers U. Coop. E & S Ass'n,* 377 F. 2d 672, 679 (10th Cir. 1967) ("Practical experience may be the basis of qualification as well as academic training."); *Santana Marine Service, Inc.* v. *McHale,* 346 F. 2d 147, 148 (5th Cir. 1965) ("A person may become qualified as an expert by practical experience and home study. Professional education is not a prerequisite."). Aaron and Harry Kraut, by their experience, were the best witnesses that one could find on the fair market value of the stock of Nassau Corp.

The fact that the witness is a party to the action and personally interested in establishing the value of the property involved does not disqualify him to testify and give his opinion as to the value if otherwise competent. *Knickerbocker Life Ins. Co.* v. *Nelson,* 78 N.Y. 137, 146 (1879); *Hangen* v. *Hachemeister,* 114 N.Y. 566, 573 (1889); 9 N.Y. Damages Law §195; 21 N.Y. Jur. Evidence §455.

In *Hangen* v. *Hachemeister, supra,* an action brought to recover the value of certain personal property, the plaintiff was permitted to testify as to value. The lower court admitted the evidence but subsequently held that the plaintiff was not qualified to give an opinion as to the value of

the property on the ground that he was not an expert. The Court of Appeals, however, held that the plaintiff was competent to express his judgment as to the value of the property and held the evidence competent.

In *Knickerbocker* v. *Nelson, supra,* the defendant testified to the value of the property at issue. The Court of Appeals held that even though the defendant was interested and his opinion subject to bias he was nonetheless qualified to express an opinion and was competent as a witness.

The government, in its brief, following Judge Raum, mistakenly argues that Nassau Corp "owned few assets" (25). The government completely overlooked the fact, as did Judge Raum, that Nassau Corp had a trade secret which had a potential of making millions in profits and did make more than $2,000,000.

Conclusion

The taxpayers repeat that the decisions below should be reversed and the deficiencies annulled.

Respectfully submitted,

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Affidavit of Service by Mail

In re:

Aaron Kraut and Iris Kraut, Harry Kraut and Marian Kraut v. Commissioner of Internal Revenue

State of New York
County of New York, ss.:

Harry Minott,

being duly sworn, deposes and says, that he is over 18 years of age. That on OCT 31 1975, 197..., he served 3 copies of the within Reply Brief in the above named matter on the following counsel by enclosing said three copies in a securely sealed postpaid wrapper addressed as follows:

Department of Justice
Washington, D.C. 20530
ATT: Scott P. Crampton, Esq.
Tax Division

and depositing same in the official depository under the exclusive care and custody of the United States Post Office Department within the City of New York.

and depositing same at the Post Office located at Howard and Lafayette Streets, New York, N. Y. 10013.

Harry Minott

Sworn to before me this 31st
day of Oct. 1975

Jack A. Messina

JACK A. MESSINA
Notary Public, State of New York
No. 30-2673500
Qualified in Nassau County
Cert. Filed in New York County
Commission Expires March 30, 1977